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THE CONSTITUTIONALITY OF THE UNITED STATES CORPORATION TAX.

Congress at its last session passed an Act which is commonly known as the Corporation Tax Law. This Act imposes what is spoken of as "a special excise tax" of one per cent. upon the entire net income over and above $5,000 received from all sources during the year, exclusive of amounts received as dividends upon stock of other corporations, joint stock companies, etc., subject to the tax imposed, on every corporation, joint stock company or association, organized for profit and having capital stock represented by shares, and every insurance company, organized under the laws of the United States or any State or territory of the United States or under the Acts of Congress applicable to Alaska or the District of Columbia or organized under the laws of any foreign country and engaged in business in any State or territory of the United States or in Alaska or in the District of Columbia. All corporations having a net income of less than $5,000 received by them from business transacted and capital invested within the districts affected by the law, exclusive of amounts received as dividends upon stock of other corporations, and a series of benevolent, philanthropic and charitable corporations enumerated in the Act, are exempted in the Act from the payment of this tax.

Elaborate provisions are made for the determination of what is net income, and reports and returns in great detail as to the amount of capital stock, bonded indebtedness, gross income, and all ordinary and necessary expenses and losses, are to be made to the Commissioner of Internal Revenue for the purpose of enabling the government to determine the taxable net income of the corporations subjected to the payment of the tax.

As this is the first time in the history of the country that Con-

gress has attempted to impose a tax on corporations as such, the question naturally arises: Is this tax constitutional?

The powers of taxation which have been vested in Congress by the Constitution of the United States are subject to two kinds of limitations; these are, first, those contained in express provisions of the Constitution; and, second, those which are implied from the general theory of Federal government at the foundation of the Constitution, which have as much restrictive force on the powers of Congress as are possessed by the limitations to be found in express constitutional provisions.

Let us, therefore, take up one by one the limitations, both express and implied, and endeavor to ascertain whether they apply to the new corporation tax.

First. Express limitations on the taxing power of Congress to be found in the Constitution.

The only express limitations contained in the Constitution which can be conceived of as applying to this tax law are:

1. The provision in Article I, section 2, paragraph 3, that "direct taxes shall be apportioned among the several States which may be included within this Union according to their respective numbers," etc., and that in Article I, section 9, paragraph 4, that "no capitation or other direct tax shall be laid unless in proportion to the census enumeration hereinbefore directed to be taken."

Is a tax on the net income of corporations derived from all sources a direct tax? We have at least three decisions of the Supreme Court of the United States bearing on this question. These are *Pacific Insurance Company* v. *Soule*,[1] which holds that a tax on the premiums of insurance companies and individuals engaged in insurance is not a direct tax; and *Springer* v. *United States*[2] as limited by *Pollock* v. *Farmers' Loan and Trust Company*,[3] which hold that a tax on income not derived from property but merely from labor or business is not a direct tax.

The *Pollock* cases, however, decided as well that a tax on the rents and income of property both real and personal is a direct tax and therefore not constitutional if it is not apportioned among the States. In the decision on the rehearing of the *Pollock* case[4] the Court said:

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[1](1868) 7 Wall. 433.

[2](1880) 102 U. S. 586.

[3](1895) 157 U. S. 429; 158 U. S. 601.

[4](1895) 158 U. S. 601, 618, 637.

"We are now permitted to broaden the field of inquiry, and to determine to which of the two great classes a tax upon a person's entire income, whether derived from rents, or products, or otherwise, of real estate, or from bonds, stocks, or other forms of personal property, belongs; and we are unable to conclude that the enforced subtraction from the yield of all the owner's real or personal property, in the manner prescribed, is so different from a tax upon the property itself, that it is not a direct, but an indirect tax, in the meaning of the Constitution."

In summing up its conclusions it reiterated its opinion in the following words:

"Our conclusions may, therefore, be summed up as follows:

First. We adhere to the opinion already announced, that, taxes on real estate being indisputably direct taxes, taxes on the rents or income of real estate are equally direct taxes.

Second. We are of opinion that taxes on personal property or on the income of personal property, are likewise direct taxes.

Third. The tax imposed by sections twenty-seven to thirty-seven, inclusive, of the act of 1894, so far as it falls on the income of real estate and of personal property, being a direct tax within the meaning of the Constitution, and, therefore, unconstitutional and void because not apportioned according to representation, all those sections, constituting one entire scheme of taxation, are necessarily invalid."

This is the last word of the Supreme Court on this particular point and it is difficult to see how that body, without reversing the *Pollock* cases, can well hold that a tax on the net income of corporations from all sources is constitutional as to that part of the income which is derived from either real or personal property.

The contention was made before the court in the *Pollock* cases that the selection of the entire income as the basis of the tax in some way causes that portion of it derived from property to lose its distinctive character by being merged in an indistinguishable mass somewhat after Chief Justice Marshall's idea, expressed in *Brown* v. *Maryland*,[5] that imported articles lose their distinctive character as imports and become merged in the general property in the State by passing out of the hands of the original importer or by being taken from the original package in which they were imported. This contention would not, however, appear to be approved by the Supreme Court. It is true that the Court had at one time in the case of other taxes given its adherence to this doctrine and upheld a State tax on railway gross receipts, where

[5](1827) 12 Wheat. 419.

a portion of such receipts had been derived from commerce between the States. The first, and indeed the principal, ground of the decision of this case was that, as the tax was not levied until the expiration of each half year and until the money received for freights and from other sources of income had actually come into the company's hands, that portion of the receipts derived from commerce between the several States had "lost its distinctive character as freight earned, by having become incorporated into the general mass of the company's property."[6] This doctrine was, however, distinctly repudiated by the Supreme Court fifteen years later when it said:

> "A review of the question convinces us that the first ground on which the decision in *State Tax on Railway Gross Receipts* was placed is not tenable; that it is not supported by anything decided in *Brown* v. *Maryland;* but, on the contrary, that the reasoning in that case is decidedly against it."[7]

This is the view which the Supreme Court takes in one of the last, if not the last, of these railway receipts cases which it has decided,[8] where it is held that a State gross receipts tax on a railway, a large portion of whose receipts come from commerce between the States, is unconstitutional.

The only point in which the present corporation tax differs from these gross receipts taxes is that it is imposed on net income rather than upon gross receipts, but this difference cannot be expected to influence the decision as to the point in issue, since the income tax law which was declared improper as to income from property in the *Pollock* cases specially provided that "in computing incomes the necessary expenses actually incurred in carrying on any business, occupation or profession shall be deducted and also all interest due or paid within the year by such person on existing indebtedness." The *Pollock* cases, therefore, decided that a tax on net income was improper in so far as the income was derived from property.

It is to be remembered, however, that the *Pollock* cases, while deciding that a tax on the income from property was improper where such tax was not apportioned among the States, must, when read in connection with the *Springer* case[2] and the *Pacific Insurance Company* case,[1] be regarded as deciding that a tax on the

[6]State Tax on Railway Gross Receipts (1872) 15 Wall. 284, 295.

[7]Philadelphia etc. Steamship Co. *v.* Pennsylvania (1887) 122 U. S. 326.

[8]Galveston, Harrisburg & San Antonio Ry. Co. *v.* Texas (1908) 210 U. S. 217.

income from business and labor is not a direct tax and therefore need not be apportioned among the States.

In the second *Pollock* case the Court decided that the whole income tax law was void because as a result of its decision that incomes from property were not taxable "what was intended as a tax on capital would remain in substance a tax on occupations and labor." The Court did not "believe that such was the intention of Congress." But a belief on the part of the Court that the present corporation tax law is unconstitutional in so far as it imposes a tax on the income from property would not necessarily involve the decision that the whole law is invalid. For, under the former law the tax was imposed on individuals as well as upon corporations; under the present law the tax is imposed on corporations organized for profit and on insurance companies. As few corporations subject to the tax are organized for any other purpose than to carry on a business, it may well be argued that the intention of Congress in passing the law was to tax business rather than capital and that therefore the inclusion of income from property is not, in the words of the Court, "a vital part of the scheme for taxation embodied in the law." If this is the case the Court may properly hold that from the viewpoint of the direct tax clauses of the Constitution, the tax is constitutional in so far as it is levied on net income not derived from property. Indeed, the actual decision in the first *Pollock* case is

"that the decree of the Circuit Court is reversed and the cause remanded with directions to enter a decree in favor of the complainant in respect only of the voluntary payment of the tax on the rents and income of the real estate of the defendant company and of that which it holds in trust and on the income from the municipal bonds owned or so held by it."

This decision was reached because the Court was equally divided on the proposition "whether the void provisions as to rents and income from real estate invalidated the whole act."

The corporation tax law is, therefore, not unconstitutional as imposing an unapportioned direct tax, except in so far as it imposes a tax on income derived from property, and the unconstitutionality of this portion of the law will not have the result of causing the whole law to be unconstitutional.

2. The Constitution in Article I, section 8, paragraph 1, provides that Congress shall have power "to lay and collect taxes, duties, imposts and excises, * * * but all duties, imposts and excises shall be uniform throughout the United States."

Is, now, the tax on corporations "uniform throughout the United States"?

Several objections may be made to the corporation tax on the ground of its non-uniformity.

Thus the Act exempts from taxation certain specified kinds of corporations and all corporate incomes less than $5,000, and permits the deduction of $5,000 from all incomes above that amount in the ascertainment of the net income subjected to the tax. It was claimed that the income tax law under consideration in the *Pollock* cases violated the uniformity principle in making exemptions similar to those made in the corporation tax law. In the first *Pollock* case the Court was equally divided on the question whether the income tax law violated the requirements for uniformity, and in the second *Pollock* case it did not consider the question since it was able to base its decision on other grounds.

Since the decision of the *Pollock* cases, however, the Court has reached a decision as to the meaning of the uniformity provision. In the case of *Knowlton* v. *Moore*[9] the contention was made that because a statute imposing an inheritance tax exempted "legacies and distributed shares in personal property below ten thousand dollars, because it classifies the rate of tax according to the relationship of the taker to the deceased, and provides a rate progressing by the amount of the legacy or share, therefore the tax is repugnant to that portion of the first clause of section 8 of Article I of the Constitution, which provides that 'duties, imposts and excises shall be uniform throughout the United States.'" Mr. Justice White delivered the opinion of the Court in this case. This opinion, which is an exhaustive one, naturally considered, among other things, this contention, and the decision is reached that the uniformity required by the Constitution is a geographical and not an intrinsic uniformity. The Court says:

"By the result then of an analysis of the history of the adoption of the Constitution it becomes plain that the words 'uniform throughout the United States' do not signify intrinsic but geographical uniformity."

According to this decision a tax is constitutional from the viewpoint of the uniformity clause even if it selects a specific class of objects, persons, processes or operations, provided its effect on those objects, persons, processes or operations is the same in all parts of the United States where those objects and persons are found and those operations and processes take place.

[9](1900) 178 U. S. 41.

It may therefore safely be said that the corporation tax is not unconstitutional because violative of the uniformity clause and that, on that account and because not a direct tax, in so far as it imposes a tax on the income derived from business, it is not forbidden by the express provisions of the Constitution limiting the taxing powers of Congress.

Second. Is the corporation tax, however, forbidden by the limitations of the Constitution derived from the general theory of Federal government?

Early in the history of the Constitution Chief Justice Marshall laid down a fundamental principle derived from the federal character of our government, whose application has limited the taxing power of the States on the one hand and of the Congress of the United States on the other hand. The first case in which this was done was, as is well known, the great case of *McCullough* v. *Maryland.*[10] In this case Marshall assumed: that a federal government is necessarily based on the existence of two governmental organizations, on the one hand a national government, on the other the State governments; that each of these governments has powers recognized by the Constitution as belonging to it, the exercise of which cannot be hindered or hampered by the other; and that, as the power to tax is the power to destroy, neither government can use its taxing powers so as to interfere with the exercise of its recognized powers by the other government. He says:

"If we apply the principle for which the State of Maryland contends, to the Constitution generally, we shall find it capable of changing totally the character of that instrument. We shall find it capable of arresting all the measures of the government, and of prostrating it at the foot of the States. The American people have declared their Constitution, and the laws made in pursuance thereof to be supreme; but this principle would transfer the supremacy, in fact, to the States.

If the States may tax one instrument, employed by the government in the execution of its powers, they may tax any and every other instrument. They may tax the mail; they may tax the mint; they may tax patent rights; they may tax the papers of the custom house; they may tax judicial process; they may tax all the means employed by the government, to an excess which would defeat all the ends of government. This was not intended by the American people. They did not design to make their government dependent on the States."

The conception of Federal government, however, involves, as has been said, the existence not merely of the national but as well

[10](1819) 4 Wheat. 316, 432.

of the State governments. The Supreme Court has therefore held in a series of cases beginning with *The Collector* v. *Day*[11] that the United States may not tax a necessary instrumentality of State government or hamper or interfere with the exercise by the States of a power recognized as theirs by the United States Constitution. In *The Collector* v. *Day,* holding that the United States might not tax the salary of a judicial officer of a State, Mr. Justice Nelson says:

"The general government, and the States, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former in its appropriate sphere is supreme; but the States within the limits of their powers not granted, or, in the language of the tenth amendment, 'reserved,' are as independent of the general government as that government within its sphere is independent of the States. * * * Such being the separate and independent condition of the States in our complex system, as recognized by the Constitution, and the existence of which is so indispensable, that, without them, the general government itself would disappear from the family of nations, it would seem to follow, as a reasonable, if not a necessary consequence, that the means and instrumentalities employed for carrying on the operations of their governments, for preserving their existence, and fulfilling the high and responsible duties assigned to them in the Constitution, should be left free and unimpaired, should not be liable to be crippled, much less defeated by the taxing power of another government, which power acknowledges no limits but the will of the legislative body imposing the tax."

Applying this principle, it has been held or said in later cases that the United States may not tax the obligations of indebtedness of States,[12] or of the municipal corporations within the States,[13] the property of municipal corporations[14] or the bonds required from applicants for licenses to sell liquor under the licensing laws of a State.[15] There are thus many well considered cases decided by the Supreme Court which would seem to lay down the rule that the United States Congress may not use its taxing power so as to destroy or impair a power recognized as belonging to the States.

There is, however, a rather recent case which, it must be

[11](1870) 11 Wall. 113, 124, 125.

[12]Mercantile Nat. Bk. *v.* New York (1887) 121 U. S. 138, 162, approved in the first Pollock case, *supra.*

[13]The first Pollock case, *supra.*

[14]U. S. *v.* Railroad Co. (1872) 17 Wall. 322.

[15]Ambrosini *v.* U. S. (1902) 187 U. S. 1.

confessed, seriously limits the application of this principle. This case is *South Carolina* v. *United States.*[16] In this case the question was raised as to the power of the United States to tax the State dispensaries of South Carolina. The court decided that the tax was proper, and based its decision on two grounds. The first is that a recognition of the immunity of the State dispensaries from taxation might easily lead to the destruction of the taxing powers of the United States. For, as Mr. Justice Brewer says,

"The profits from the business in the year 1901, as appears from the findings of fact, were over half a million of dollars. Mingling the thought of profit with the necessity of regulation may induce the State to take possession, in like manner, of tobacco, oleomargarine, and all other objects of internal revenue tax. If one State finds it thus profitable other States may follow, and the whole body of internal revenue tax be thus stricken down.

More than this. There is a large and growing movement in the country in favor of the acquisition and management by the public of what are termed public utilities, including not merely therein the supply of gas and water, but also the entire railroad system. Would the State by taking into possession these public utilities lose its republican form of government?

We may go even a step further. There are some insisting that the State shall become the owner of all property and the manager of all business. Of course, this is an extreme view, but its advocates are earnestly contending that thereby the best interests of all citizens will be subserved. If this change should be made in any State, how much would that State contribute to the revenue of the Nation? If this extreme action is not to be counted among the probabilities, consider the result of one much less so. Suppose a State assumes under its police power the control of all those matters subject to the internal revenue tax and also engages in the business of importing all foreign goods. The same argument which would exempt the sale by a State of liquor, tobacco, etc., from a license tax would exempt the importation of merchandise by a State from import duty. While the State might not prohibit importations, as it can the sale of liquor, by private individuals, yet paying no import duty it could undersell all individuals and so monopolize the importation and sale of foreign goods.

Obviously, if the power of the State is carried to the extent suggested, and with it is relief from all Federal taxation, the National Government would be largely crippled in its revenues. Indeed, if all the States should concur in exercising their powers to the full extent, it would be almost impossible for the Nation to collect any revenues. In other words, in this indirect way it would be within the competency of the States to practically destroy the efficiency of the National Government."

[16](1905) 199 U. S. 437, 454, 455, 457, 458.

In the second place the court regards the matter from a historical point of view:

"Looking, therefore, at the Constitution in the light of the conditions surrounding at the time of its adoption, it is obvious that the framers in granting full power over license taxes to the National Government meant that that power should be complete, and never thought that all the States by extending their functions could practically destroy it.

If we look upon the Constitution in the light of the common law we are led to the same conclusion. All the avenues of trade were open to the individual. The Government did not attempt to exclude him from any. Whatever restraints were put upon him were mere police regulations to control his conduct in the business and not to exclude him therefrom. The Government was no competitor, nor did it assume to carry on any business which ordinarily is carried on by individuals. Indeed, every attempt at monopoly was odious in the eyes of the common law, and it mattered not how that monopoly arose, whether from grant of the sovereign or otherwise. The framers of the Constitution were not anticipating that a State would attempt to monopolize any business heretofore carried on by individuals."

Can *South Carolina* v. *United States* fairly be said so to modify the rule as to the power of the United States to tax the agencies or powers of the State government as to cause us to conclude that the United States may tax a State corporation if it is conceded that such a tax will be in its essence a tax on a constitutional power of a State?

It is believed that this effect can hardly be attributed to this case and for the following reasons:

In the first place the denial of the right to tax such corporations may not be said to imperil the revenue powers of the national government. For the government has been recognized as having the right to tax the income from business of all persons both individuals and corporations engaged in a taxable business.[1]

In the second place the State power which under such conditions would be taxed by the new corporation tax law is not a power, like the power to establish a monopoly of the sale of liquor, which has only recently been exercised by a State, but is one which on the contrary was exercised by the States before the adoption of the Constitution, and has been exercised continuously and without interruption by them ever since with the approval, expressed times without number, of the Supreme Court. It would not seem conceivable, therefore, that the Supreme Court could regard *South Carolina* v. *United States* as justifying it in recognizing the cor-

poration tax law as constitutional if it believed that the law taxes one of the powers of the State.

Congress has evidently feared that its action in imposing a tax on corporations would be considered improper as imposing a tax on a power of the States. For it has gone out of its way to declare that the tax is a "special excise tax," undoubtedly apprehending that, in default of such expression, the tax might be regarded as a corporation tax and therefore as interfering with a power of State government.

But it cannot be assumed that the Supreme Court will permit its judgment of the character of the tax to be controlled by such a statement on the part of Congress; it will be governed in its determination by the true nature of the tax. Indeed, the Court said in *Knowlton* v. *Moore:*

"In the course of the opinion in the *Pollock* case it was said that, if a tax was direct within the constitutional sense, the mere erroneous qualification of it as an excise or duty would not take it out of the constitutional requirement as to apportionment. * * * This language was * * * a statement that a tax which was in itself direct, because imposed upon property solely by reason of its ownership, could not be changed by affixing to it the qualification of excise or duty." [17]

In coming to its conclusion as to the nature of the corporation tax the Supreme Court will not find many if any precedents upon the exact point at issue. The most important case to be considered will unquestionably be *Pacific Insurance Company* v. *Soule,*[1] which upheld as constitutional, as has been said, a tax levied on insurance premiums. The law in this case, however, differed from the present law in that it imposed the tax on "every insurance company" and "every association or individual engaged in the business of insurance," [18] while the law we are considering is confined to corporations. The law at issue in the *Pacific Insurance Company* case might, because of its application to all persons, individuals as well as corporations, engaged in the insurance business, well be regarded as an excise or business tax and not a corporation tax, although this point is not even referred to by the Court, which confines its attention altogether to the determination of the question whether the tax was direct or not. The present corporation tax law affects corporations only, and may therefore well be regarded as a corporation tax by a court which has in a number of

[17] Knowlton *v.* Moore (1900) 178 U. S. 41, 81.
[18] 13 U. S. Statutes at Large, 276.

cases upheld a State tax on the dividends or amount of business of domestic corporations as a corporate franchise tax.[19]

If the tax under consideration were regarded as a corporate franchise tax, there would be a danger that it might be regarded as a tax on a power of the States. There has, however, been a marked tendency on the part of the Supreme Court in its tax cases to distinguish between the exercise of a power by a State, which it recognizes may not be taxed by Congress, and the concrete effects of the exercise of the power through the co-operation, voluntary or involuntary, on the part of individuals, which effects it considers taxable by Congress.

One of the first of the cases in which such a distinction is hinted at is the *License Tax Cases.*[20] In this case the Supreme Court held that Congress could impose a tax on persons who actually were engaged in an occupation prohibited by the law of a State. The only question before the Court was whether the law of Congress imposing the tax could be regarded as legalizing an occupation which by the State law was illegal. The Court in reaching its determination distinguished between the police power which was possessed, and in the particular case exercised by the State, and the taxing power which was possessed by the United States and whose exercise in the case before the Court was held not to have interfered with the State's police power. The question did not arise, and therefore was not decided, as to the power of the United States to tax an occupation licensed by the State, but as a matter of fact Congress has for many years and without objection on the part of the States been doing this very thing. It is, however, to be noticed that in two cases the Supreme Court has denied the right of the State to tax an occupation which has been licensed by the United States.[21] In both these cases a city ordinance imposing a license tax on steam vessels engaged in the towing business was declared to be unconstitutional since the vessels concerned had been, in accordance with a law of Congress, already licensed by the United States.

The most important, if not the first case in which the distinction referred to was made, is, however, *Knowlton* v. *Moore,*

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[19]Society for Savings *v.* Coite (1867) 6 Wall. 594; Provident Institution *v.* Mass. (1867) *Ibid,* 611; Hamilton Company *v.* Mass. (1867) *Ibid,* 632; Home Ins. Co. *v.* N. Y. (1890) 134 U. S. 594.

[20](1866) 5 Wall. 462.

[21]Moran *v.* New Orleans (1884) 112 U. S. 69; Harman *v.* Chicago (1893) 147 U. S. 396.

to which reference has been already made in another connection. This case, it will be remembered, upheld the constitutionality of a tax imposed by the United States on inheritances. Among the objections made to the tax was the contention that the United States was taxing "rights created solely by state law, depending for their continued existence on the consent of the several states, a volition which Congress has no power to control and as to which it could not therefore exercise its taxing authority."

The court considers this contention as unsound for three reasons. First it

"denies to Congress the right to tax a subject-matter which was conceded to be within the scope of its power very early in the history of the government. * * * It is, moreover, worthy of remark that similar taxes have at other periods and for a considerable time been enforced; and, although their constitutionality was assailed on other grounds held unsound by this Court, the question of want of authority of Congress to levy a tax on inheritances and legacies was never urged against the acts in question."

Second: "All courts and all governments, however, * * * conceive that the transmission of property occasioned by death, although differing from the tax on property as such, is, nevertheless, a usual subject of taxation. Of course, in considering the power of Congress to impose death duties, we eliminate all thought of a greater privilege to do so than exists as to any other form of taxation, as the right to regulate successions is vested in the States and not in Congress."

Thiid, the contention itself rests on the fallacy

"that the tax on the transmission or receipt of property occasioned by death is imposed on the exclusive power of the State to regulate the devolution of property upon death. The thing forming the universal subject of taxation upon which inheritance and legacy taxes rest is the transmission or receipt, and not the right existing to regulate. In legal effect, then, the proposition upon which the argument rests is that wherever a right is subject to exclusive regulation, by either the government of the United States on the one hand or the several States on the other, the exercise of such rights as regulated can alone be taxed by the government having the mission to regulate. But when it is accurately stated, the proposition denies the authority of the States to tax objects which are confessedly within the reach of their taxing power, and also excludes the national government from almost every subject of direct and many acknowledged objects of indirect taxation. Thus imports are exclusively within the taxing power of Congress. Can it be said that the property when imported and commingled with the goods of the State cannot be

taxed, because it had been at some prior time the subject of exclusive regulation by Congress? Again, interstate commerce is often within the exclusive regulating power of Congress. Can it be asserted that the property of all persons or corporations engaged in such commerce is not the subject of taxation by the several States, because Congress may regulate interstate commerce? Conveyances, mortgages, leases, pledges, and, indeed, all property and the contracts which arise from its ownership, are subject more or less to state regulation, exclusive in its nature. If the proposition here contended for be sound, such property or dealings in relation thereto cannot be taxed by Congress, even in the form of a stamp duty. It cannot be doubted that the argument when reduced to its essence demonstrates its own unsoundness, since it leads to the necessary conclusion that both the National and State governments are divested of those powers of taxation which from the foundation of the government admittedly have belonged to them. Certainly, a tax placed upon an inheritance or legacy diminishes, to the extent of the tax, the value of the right to inherit or receive, but this is a burden cast upon the recipient and not upon the power of the State to regulate."[22]

Assuming that the arguments are sound, how do they affect the new corporation tax? The first, viz., that a tax is constitutional because it has been imposed since the beginning of the government, does not apply because this is the first time Congress has imposed a tax on corporations as corporations and not as individuals engaged in a taxable business. Nor does the second apply, since corporations as such have not been nearly as generally subjects of taxation as inheritances. But what shall be said as to the third argument? Do the same reasons which justify the taxation by the United States of inheritances permitted by a State law justify the taxation by that government of corporations organized under State law?

To answer this question we must first determine what the law attempts to tax, in other words what from the legal point of view is the incidence of the tax. As the tax is not imposed, as was the tax considered in *Pacific Insurance Company* v. *Soule*, on corporations and individuals engaged in a business which has been selected for taxation, it must be admitted, as has been intimated, that the tax is not a tax on business. On the contrary it is imposed on all corporations organized for profit and insurance companies. As it is not imposed on corporations and individuals, nor on corporations engaged in a particular line of business except in the case of insurance companies, but on corporations organized

[22]Knowlton *v.* Moore (1900) 178 U. S. 41, 56-60.

for profit, we can hardly escape the conclusion that the reason for imposing the tax is that the person taxed is a corporation, and that the legal incidence of the tax is upon corporations as such and therefore upon corporate franchises. Such must be our conclusion after reading cases like *Home Insurance Company* v. *New York, Society for Savings* v. *Coite, Provident Institution* v. *Massachusetts,* and *Hamilton Manufacturing Company* v. *Massachusetts,*[19] where the Supreme Court reaches the conclusion that what is taxed by a law imposing a tax on corporations, measured in amount by the dividends declared, by the average amount of deposits, or the market value of its stock is the corporate franchise. Now, the corporate franchise is defined as "the right or privilege given by the State to two or more persons of being a corporation, that is, of doing business in a corporate capacity." [23]

It may perhaps be said that, because the corporation tax especially exempts certain corporations organized by the States and taxes corporations organized by the United States and by foreign countries, it may not be regarded as directed specially against franchises granted by the State. The mere exemption of certain specified corporations cannot be taken as in any way significant since the exempt class embraces merely philanthropic, charitable and benevolent corporations which are not usually liable in any system of taxation. The non-discriminating character of a tax has also been held in most instances to have no significance in determining its constitutionality, provided the legal incidence of the tax is actually upon the prohibited object.[24]

It may also be said that the new corporation tax is measured by the amount of the net earnings. This cannot affect the case since in one of the cases referred to, coming up from New York, viz., *The Home Insurance Co.* case[19] the Court held that measuring the tax by the dividends which are in essence equivalent to net earnings paid did not make the tax a tax on the capital stock or property of the corporation and that therefore it was not necessary to deduct in reaching the amount of the tax the interest received on the bonds of the United States owned by the corporation.

Can it now be said that the corporation tax as a tax on the corporate franchises of corporations organized by State laws taxes one of the powers of the State governments?

[23]Home Ins. Co. *v.* N. Y., *supra.*

[24]Bank of Commerce *v.* New York City (1862) 2 Black 620; Low *v.* Austin (1871) 13 Wall. 29; Robbins *v.* Shelby County Taxing Dist. (1887) 120 U. S. 489.

One of the powers which have been recognized from the beginning of our history as peculiarly a power of the State governments is the power to create corporations. It is a power, further, which has been recognized by the Supreme Court, which has said time and again and in no uncertain way that the creation and existence of a domestic corporation is a matter entirely within the discretion of a State so far as the latter's action does not violate the constitutional provision forbidding a State to pass any law impairing the obligation of a contract.[25] It has also been held that a State may not tax a corporation legally chartered by the United States. This principle was at the basis of *McCullough* v. *Maryland*,[10] in which it was held that a State could not impose a tax on the United States Bank, and has been reaffirmed in a series of cases with regard to the power of the States to tax the national banks, one of the latest and most important of which is *Owensboro National Bank* v. *Owensboro*.[26] In this case the Court considered the constitutionality of a State law providing that "every incorporated bank * * * shall in addition to the other taxes imposed on it by law annually pay a tax on its franchise to the state." The Court held that, assuming that the tax actually imposed on the bank was a tax on its franchise, it was void as repugnant to the Act of Congress providing, under the Constitution of the United States, that national banks should not be taxed by the States but that the shares of national bank stock might be taxed in the hands of the holders. But does it follow from these decisions that State taxes on banks incorporated by the United States are improper, that United States taxes on corporations organized under State laws are improper? It would seem not. For a State tax on banks incorporated by the United States was improper not so much because it was upon a corporate franchise granted by the United States, but because the particular corporation upon which it was levied was, in addition to being a corporation chartered by the United States, an instrument or agent of the United States formed not merely to do business for its incorporators but to aid the United States government in the performance of one of its constitutional duties. This, it must be confessed, cannot be said of the corporations organized for profit under a State law. These corporations may have been formed through the exercise of a power which is recognized as belonging

[25]See *e. g.*, Horn Silver Mining Co. *v.* N. Y. (1892) 143 U. S. 305.
[26](1899) 173 U. S. 664.

to the States but have not been formed for the purpose of aiding the States in the discharge of their governmental functions. Therefore the United States Bank and the National Bank tax cases may not be said to be applicable even if we admit that the United States and the States are governed by the same rules in the exercise of the right to tax the results of the exercise of each other's powers.

The only reason for holding that the United States may not tax a corporate franchise granted by a State is then to be found in the fact that because the power to tax is the power to destroy, the United States may in this way destroy one of the State's powers.

In their determination as to the powers of the States to tax the effects or results of the exercise by the United States of its powers the State courts have been governed by this idea. They have therefore held that the States may not tax letters patent or copyrights issued by the United States.[27] But the Supreme Court of the United States has not up to the present time been equally regardful of the powers of the States. It has in *Knowlton* v. *Moore* recognized the right of the United States to impose a tax on inheritances, which it has regarded as the effects of the exercise of the power of the State to regulate inheritances, while Congress has without opposition and for a long time, probably because of the decision in the *License Tax Cases,* imposed a special excise tax on the holders of State licenses to sell liquor, notwithstanding the Supreme Court has denied the right of the States to tax steamboats licensed by the United States to use the navigable waters of the United States. Indeed, the only cases where the Supreme Court has interfered to protect the States against the exercise of the taxing power of Congress have been in the cases of the salaries of State officers, the evidences of indebtedness of the States and their local corporations, and the property of the States and their local corporations, where in its opinion that property is used for a necessary purpose of State government, and liquor license bonds required under a State liquor license law.

The Supreme Court may not thus be said to have been active in the defense of the powers of the States against congressional action. It is therefore very doubtful if it will regard the corpora-

[27] People *v.* Assessors (1898) 156 N. Y. 417; People *v.* Roberts (1899) 159 N. Y. 70; Commonwealth *v.* Electric Co. (1892) 151 Pa. St. 265.

tion tax law as unconstitutional because interfering with or hampering the exercise of one of the powers which by our system of Federal government are recognized as belonging to the States.

The answer to the question as to the constitutionality of the United States corporation tax would seem then to be that it is constitutional except in so far as it imposes a tax on income derived from property. Except as to that portion of it, it is not a direct tax and therefore need not be apportioned among the States. It is uniform throughout the United States, and it would appear not to violate the obligation of Congress, arising out of the theory of Federal government, not to interfere with the powers of the States.

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